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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000688

SIPDIS

DEPT FOR EUR/CARC, SCA/CEN, S/E MORNINGSTAR

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TAGS: [ENRG](#) [EPET](#) [AJ](#) [TU](#) [TX](#)

SUBJECT: AZERBAIJAN: SPECIAL ENVOY MORNINGSTAR, PRESIDENT ALIYEV DISCUSS NABUCCO, TURKEY GAS TRANSIT

REF: A. BAKU 646

[1B.](#) BAKU 605

Classified By: Charge d'Affaires Donald Lu, Reasons 1.4 (b) and (d)

¶1. (C) Summary: Suggesting that Turkey is putting short-term gas needs for its domestic market ahead of longer-term objectives to transport gas to Europe, President Aliyev questioned Turkey's commitment to constructing Nabucco. In a conversation with Special Envoy Morningstar on August 27, Aliyev referred to recent talks with the Turks as a failure and lamented a loss of momentum in negotiations. Increasing Russia-Turkey cooperation on energy, including a possible nuclear deal, is troubling, he said. Pricing disputes over Shah Deniz Phase I and II gas continue, as do continuing differences on the volume of Phase II gas to be sent to Turkey and Europe. Should gas pricing and transit talks continue to fail, President Aliyev suggested he might make a public statement this fall to place full blame on Turkey. This statement, intentionally or not, could come around the time of the proposed Turkey-Armenia soccer match, and thus affect or be affected by border and reconciliation talks. On a positive note, Aliyev suggested that the Shah Deniz Production Sharing Agreement would be extended for five years. End Summary.

¶2. (C) In an August 27 meeting with Special Envoy for Eurasian Energy Ambassador Richard Morningstar, President QAliyev characterized again (ref a) Azerbaijan's August talks on natural gas prices and transit with Turkish counterparts in Nakhchivan Province as a "failure." Turkey in particular is not being constructive on transit tariffs, he said, still "demanding two times normal tariff levels." The President speculated that in the near-term, at least, the Turks may not want a larger deal on Nabucco, which would carry Azerbaijan's and perhaps Central Asia's gas to Central Europe. "This is a signal, perhaps, that the Turks are not serious," he said.

¶3. (C) Rather, Turkey's short-term goal, the President suggested, is to lower the average price on imports and provide cheaper gas to the domestic market. Unfortunately, he added, the Turks still hold the impression that Azerbaijan does not have any alternatives and that over the longer-term Turkey must be the hub for natural gas transit from Azerbaijan, Central Asia, Iraq and Iran to Europe. This cable covers President Aliyev's comments on Turkey and gas transit issues; the President's comments on Turkmenistan and Kazakhstan are reported septel.

Momentum Lost on Summer Transit Breakthrough

¶4. (C) Russian Prime Minister Putin's early August visit to Ankara, where he met with Prime Minister Erdogan, was a clear signal that Russia intends to undermine Nabucco, President Aliyev said. The visit, in his view, worked to reverse momentum in Azerbaijan's discussions with Turkey on transit. Prior to the Putin visit -- especially in the aftermath of the appointment of Taner Yildiz as Turkey's Minister of Energy -- Turkey had shown signs of cooperation. This was particularly the case in the weeks that followed Azerbaijan/SOCAR's spring discussions with Russia/GazProm on natural gas exports to Russia. That momentum, however, now seems to be lost, the President reflected.

¶5. (C) Several factors could be at play, the President said. Aside from possible Turkish ambivalence on the Nabucco project related to cheaper gas for the domestic market, Turkey's greater European agenda also affects transit issues, and Nabucco in particular. Foreign Minister MammadQov separately emphasized this point to Ambassador Morningstar in a meeting earlier in the day. President Aliyev also made

reference to the civilian nuclear deal that Russia and Turkey are discussing, and wondered aloud if that project had influenced Turkey's thinking on South Stream. President Aliyev and Foreign Minister Mammadyarov separately noted huge volumes of Russian investment moving into Turkey in a range of sectors.

So Much to Negotiate, So Complicated to Agree

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¶ 16. (C) In the midst of this, Azerbaijan and Turkey are negotiating prices for gas sold directly to Turkey. Azerbaijan has continued to supply Shah Deniz Phase I gas to Turkey for many months, despite the fact there has been no agreement on a new price. The initial price on that gas -- USD 120 per thousand cubic meters (tcm) -- remains far below the "market" price in Europe and even farther below the very high price that Turkey has paid GazProm for imports through the (Black Sea) Blue Stream pipeline. Azerbaijan and Turkey meanwhile are discussing a pricing formula for sales of Shah Deniz Phase II gas, which has not yet been sanctioned. Volumes from Shah Deniz Phase II are also in dispute, i.e., how much of Azerbaijan's gas would go to the Turkish market and how much would be shipped onward to Europe. On a positive note, Aliyev suggested that the Shah Deniz Production Sharing Agreement would be extended for five years.

¶ 17. (C) SOCAR Vice President for Marketing Elshad Nasirov, who joined the President for the meeting with Ambassador Morningstar, said that he and other Shah Deniz consortium members (BP, Statoil, Total/France, etc.) are meeting this week and next to work out a counter-offer (following the Nakhchivan meeting) to the Turks. Nasirov stated that Turkey offered at Nakhchivan a "tiered" structure of transit fees, which curiously increase with greater volumes. Turkey's BOTAS allegedly put forth fees of USD 45 per tcm per 100 kilometers for volumes up to 1 billion cubic meters (bcm), USD 52 per 1 tcm per 100 km for volumes up to 7 bcm, and USD 57 per 1 tcm per 100 km for volumes up to 10 bcm. Higher prices for higher volumes, the Turks said, reflect greater capital expenditures and operating expenses. The consortium must also address the issue of Shah Deniz Phase II volumes for Turkey and Europe. After SOCAR proposed a non-tiered transit fee of USD 32 per tcm per 100 kms., BOTAS countered with a lower rate (USD 35 per tcm per 100 kms. for volumes up to 1 bcm and USD 45 per tcm for 100 kms. for volumes up to 7 bcm).

Politics Always Play a Role

¶ 18. (C) President Aliyev suggested that Azerbaijan might make a tough public statement this fall, should the next round of talks with Turkey fail. The objective, he said, would be to point out that Turkey is not being constructive and is blocking Caspian gas exports to Europe. (Comment: The timing of this would be interesting, should it happen, as the Azerbaijan-Turkey gas talks could come at about the same time as the proposed Turkey-Armenia soccer match) and thus be affected by border and reconciliation talks on that front.
End Comment.)

President Eyes Bulgaria, Greece

¶ 19. (C) The Azerbaijanis acknowledged that should talks with Turkey ultimately fail, there are few, if any, options. The Turks may be hoping, the President speculated, that the Shah Deniz partners would then have to sell all gas to Turkey. President Aliyev discussed opportunities to strike supply deals with Bulgaria and perhaps Greece, hoping aloud that the Bulgarians in particular might be able to persuade Turkey to accept transit terms. Currently, Russian gas transits Bulgaria on its way to Istanbul. This counter-arrangement, he surmised, might be used as leverage. The President was also eager for the United States to make more noise about the possibility of an under-the-Black Sea pipeline to Bulgaria or Romania and/or a Black Sea LNG project. He suggested U.S. funded feasibility studies to support these proposals. In meetings later with SOCAR, its management was less receptive to the idea for a variety of reasons (septel).

Comment: Energy Combines Economics and Politics

¶ 10. (C) Gas purchasing agreements and transit tariffs are difficult to negotiate in the best of circumstances; political stalemates over complex issues like Nagorno-Karabakh only serve to further muddy the waters. In

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separate talks ahead of SE Morningstar's visit, BP officials

suggested that some progress was made at Nachkhivan, and praised the two sides for "actually talking about numbers." Other accounts are mixed at best. Still, President Aliyev's words last week were nothing short of gloomy, and his threat to lambast the Turks publicly this fall seems rash. While it is apparent at times that Turkey is not constructive on transit talks -- and President Aliyev's point about the Turks' focus on the domestic gas market is well taken -- it also seems likely that Azerbaijan sees Turkey-Armenia reconciliation and the impact on Nagorno-Karabakh as factors in the gas transit and pricing talks. How that discussion proceeds will likely influence Azerbaijan at the energy table with Turkey.

¶11. (U) This cable was cleared by Ambassador Morningstar's staff.

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